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Disney Speaker:

Alan Bergman

President, Walt Disney Studios

PRESENTATION

Jessica Reif Cohen - *Analyst, Merrill Lynch*

Alan Bergman is President of Walt Disney Studios. The change in Disney's film strategy following its acquisition of Pixar in 2006 dramatically improved studio operating margins from just under 10% to an estimated 16% in fiscal year '08. This showed profit growth at an estimated CAGR of 26% over the two years. Following a short presentation in which Alan will discuss the studio's content strategy, we will sit down for a Q&A session.

Alan Bergman - *President, Walt Disney Studios*

Thanks, Jessica. As Jessica mentioned, today, I'm going to discuss the content strategy at the Walt Disney Studios. Our number one objective is to make quality, Disney-branded product whether it be our live action product, our animation product, our stage play or music product, it's the single most important thing we do. We're focused on Disney for a variety of reasons and as Bob and Tom have said, the *Disney Difference* gives us a competitive advantage. When people go to a theater to see a Disney-branded



movie, they know what they're going to get: great Disney-branded movies. No other studio has that kind of brand and quite frankly, it's what we do best. And over the last five years, we've had strong double-digit returns on invested capital.

Additionally, great Disney branded properties ripple through the entire company and *Pirates* is the best example of this. We released it theatrically and then on home entertainment. We sold toys, apparel, books and video games. *Pirates* also drove significant traffic to the Disney website and the updated *Pirates* ride increased attendance at our theme parks. As you can see, great Disney-branded properties lift the entire company. Also, Disney product commands a better store placement. When you go to Wal-Mart or other stores, you'll see dedicated Disney shelf space. That, combined with the fact that we make movies that people want to own, enable us to convert box office to DVD sales more efficiently than other studios. And everybody knows the importance of the home entertainment market to a film's profitability. Another advantage is the Disney marketing synergies across the company and most notably the Disney Channel.

Disney Channel has had tremendous ratings over the last several years and despite the fact that it's not ad supported, we've been able to put movie interstitials and other promotions on the channel that give our movies significant exposure to our core audience.

Additionally, high quality, Disney products stand the test of time. *Little Mermaid* is a great example of this. We released *Little Mermaid* theatrically in November of 1989 and in 1990 we released it on VHS and sold over 14 million units worldwide. Eight years later in 1998 we sold another 14 million units and in 2006, we sold another 10 million units worldwide. Clearly, great Disney branded properties stand the test of time. As a result of these factors, over 85% of our investment is now in Disney products. Now I want to discuss our product lines in a little more detail starting off with live action.

As I said, we're going to be focused on quality Disney branded properties, and as we announced a couple of years ago, we're going to be making fewer films but bigger films. And to make the best films you have to have the best filmmakers and we believe we have just that. In terms of producers we have the number one producer in Hollywood with Jerry Bruckheimer. His films speak for themselves and we have Jerry for many years to come. A couple of years ago, we signed Bob Zemeckis to a long-term deal, Bob is clearly one of the top directors of all time. We started a performance capture studio with Bob and our first movie coming out is a Christmas Carol starring Jim Carrey; it will be released in Disney Digital 3D. We also signed Tim Burton to a two-picture deal,



another one of the top directors in Hollywood, and his first movie is Disney's *Alice in Wonderland*, that will be released in 3D in 2010.

You also need to have the top actors and we believe we have some of the best. From Johnny Depp to Jim Carrey to Nick Cage, Adam Sandler and John Travolta, just to name a few. We believe with this talent, we've given ourselves the best opportunities to make great Disney branded movies. As you know, franchises also drive significant profitability to the studios and over the last several years, we've developed a number of franchises, including the *Pirates of the Caribbean*, *National Treasure* and *The Chronicles of Narnia*, all of which are strong properties to the company.

Now I want to take a few minutes and show you a concept piece from one of our upcoming films, *Tron 2*. You may remember the original *Tron* was released over 25 years ago and at the time, broke new ground by blending live action and computer animation. We expect this sequel to be as eye-popping as the original. Let's take a look at this test piece.

[VIDEO]

Pretty cool, huh? Now I want to turn to Miramax. As you know, we separated from Bob and Harvey about three years ago. We put new management in place and we've really gone back to our roots of making art house films. We're making about 6 to 10 films per year, spending approximately \$20 million per film or less and Miramax has done a fantastic job. This last year, they won six Academy Awards. They won most of the big awards. For *No Country for Old Men*, they won best actor, best picture and best director. And for *There Will Be Blood* they won best actor. We're very focused on maximizing their library. They have over 600 films with 68 Academy Awards, including 4 best pictures. We have some of the most recognizable films out there, including *Pulp Fiction*, *Kill Bill*, *Scary Movie* and *Scream*, just to name a few. So we're very focused on that library.

Another area we're excited about is our local production initiative that we launched about a year and-a-half ago. Our goal is to extend the Disney brand in emerging markets, particularly Russia, China and India. And we plan to develop and produce local language Disney-branded films that connect with the local culture. Our first film, *The Secret of the Magic Gourd*, was released in China last year and was very well-received. We currently have a number of films in development and two films in production and plan to spend over \$100 million on this initiative over the next two to three years. And we're very excited about it. We think it's really going to extend the Disney brand.



Another venture we announced earlier this year is the Disneynature label. This initiative is designed to produce high quality Disney-branded nature films and we're working with some of the best producers and directors in the genre, including Alistair Fothergill, who directed the hugely successful *Planet Earth*. We plan to release one to two films every year starting with *Earth* on April 22nd, Earth Day, and we have a robust lineup over the next five years as we believe Disneynature will enhance the Disney brand.

Now I want to turn to our animation business, the heart and soul of the company. First I want to say the acquisition of Pixar couldn't be going any better. We've been able to leverage the Pixar talent, particularly John Lasseter and Ed Catmull, who now run Disney Feature Animation and Pixar Animation. Overall we're targeting two to three films every year, one from Disney animation, and one to two from Pixar animation. And we believe we have a tremendous lineup over the next five years including *Toy Story 3* and *Cars 2*, which should be really great sequels.

Our next animated film is *Bolt* from Disney Animation Studios and features the voice talent of John Travolta and Miley Cyrus. This 3D movie comes out on November 21st and we're very, very excited about it. Let's take a look at the trailer.

[VIDEO]

It should also be noted that all of our CG films and animation going forward will be in 3D. In fact, we're huge believers of 3D. As you know, Disney released the first digital 3D movie with *Chicken Little*. At the time we only had 84 screens. Since that time we've released several other movies in 3D and now have no less than 10 3D movies that will be released over the next few years, and we believe 3D will help drive our theatrical business in the future.

I want to take some time and talk about two of our other product lines, first, our music operations. The Disney Music Group is a highly profitable business that has done an excellent job leveraging the Disney brand. They've developed a strong artist roster including *High School Musical*, that has sold over 13 million units worldwide, *Hanna Montana / Miley Cyrus* has sold nearly 8 million units and the hugely popular *Jonas Brothers*. Clearly the Music Group has worked very well with the Disney Channel over the last few years with *High School Musical* and *Miley Cyrus* and it goes both ways because the channel has benefited from the *Jonas Brothers*. This is another example of the *Disney Difference*.



The last product line I want to discuss is our theatrical productions business. This is a tremendously stable business over the last several years and in fact, *The Lion King* has generated over \$3.2 billion over the last 10 years. We also have *Mary Poppins* and *Little Mermaid* on Broadway, which have also been great brand drivers. And we have a number of productions around the world that continue to enhance Disney.

Now I want to take a few minutes and talk about our financials. Even though our revenues have been relatively flat at about \$7.5 billion over the last three years, we have been able to grow our operating income from \$200 million to a record \$1.2 billion and our margins have increased from 3% to 16% as we've implemented our strategy. And for the first three quarters of our current fiscal year, we've generated nearly \$5.9 billion in revenues and nearly \$1 billion in profit, with 17% margins. Another strong year for the studio. So, you can see, the studio's focusing on creating quality, Disney-branded product across all of our product lines. We're working hard to attract the top talent to give us the best opportunity for success and we've developed a diverse group of product lines in an effort to drive returns to The Walt Disney Company. Thank you.

Q&A

Jessica Reif Cohen – Analyst, Merrill Lynch

Okay. The first question I wanted to ask you is about the “green light” process. How many divisions within the studio is all the other Disney segments, just across the company? How many have input into the green light process? Or maybe put another way, how do you think when you're developing films or approving films, how do you think about affecting all the Disney divisions?

Alan Bergman – President, Walt Disney Studios

There's really just a handful of people that actually are involved creatively and from a business standpoint who ultimately “green light” a film. But we make sure, particularly because of the fact, that we're making bigger but fewer films, we try to make films that do impact the other divisions. *Pirates*, as an example, ripples through the different businesses, whether it be consumer products, but the Internet group or the theme parks, our goal is to try to touch as many of the divisions as we can. That's basically how it works.



Jessica Reif Cohen – *Analyst, Merrill Lynch*

Okay. And on international, which you touched on, you said that you're spending \$100 million for local production over the next two to three years. It still seems to be -- obviously, it's a very small market. Can you talk about how you see that market developing and - let's start with that, for local production?

Alan Bergman – *President, Walt Disney Studios*

You're right, currently we don't generate that much revenue or profit in the local territories. What we're trying to do is grow the Disney brand. We think we have to do that first and hopefully. We've got 15 movies or so in development and 2 movies in production, particularly in Russia, China and India. So we're hoping that we spend \$100 million, \$150 million or so, we can get that brand up there and grow the market. But it's difficult. It's not easy.

Jessica Reif Cohen – *Analyst, Merrill Lynch*

And then for the US films in international markets, they still seem to under index in DVD and theatrical. What are you doing to try to improve the US film performance in other markets?

Alan Bergman – *President, Walt Disney Studios*

From the theatrical standpoint, we actually tend to over index. The kind of films we're making now are, as I said, bigger films and they tend to do about 150% or 200% of the domestic.

Jessica Reif Cohen – *Analyst, Merrill Lynch*

In the box office, I'm sorry, I meant in DVD, in the home video part.

Alan Bergman – *President, Walt Disney Studios*

That was the theatrical part. The DVD side you're 100% right. The industry tends to under index. That's a function of - clearly the buy rates of some of these territories are much lower than in the US and piracy purchases in some of the countries. The best



thing we can do is get great quality product out there. I think Blu-ray will help us with the piracy in some respects. It's a challenge, though.

Jessica Reif Cohen – *Analyst, Merrill Lynch*

The last question on international, how much of the growth in recent years has been generated from underlying growth in the markets versus currency?

Alan Bergman – *President, Walt Disney Studios*

Virtually all of it has been the underlying growth in the business. Our currency, we have a pretty robust hedging program at Disney, so it's a very small amount as it relates to currency.

Jessica Reif Cohen – *Analyst, Merrill Lynch*

I know I said that was the last question on international, but Russia was a breakout market a few years ago. Is there anything else you see developing and what's the thing that caused Russia to grow so dramatically?

Alan Bergman – *President, Walt Disney Studios*

You know I think that obviously that economy is doing very well. As we looked at some of the smaller countries like Turkey and some of these countries we're seeing the television markets grow. So long-term, I think - currently our business at the Studio is about 40% international. I would like to see that grow by about 5% or 10% as some of these markets expand.

Jessica Reif Cohen – *Analyst, Merrill Lynch*

You recently released a new *Little Mermaid* for direct-to-video. I was just wondering if you could talk about the thought process of getting back into that market?

Alan Bergman – *President, Walt Disney Studios*

It's kind of interesting. Over the last 10 years or so, we've made hundreds of millions of dollars in the direct-to-video business. And although the last few years we've kind of



ramped it down because we just haven't had the creative in place. Because we want to make sure we have the great creative before we make the right movie. We are down to about one movie a year and the good thing is that John Lasseter and Ed Catmull are now in charge of DisneyToon Studios and our first series is the *Fairies* franchise. We will release one per year for the next four years. And we're looking for another animated franchise, so probably in the two-range as we look at that direct-to-video business. And in the live-action business, over the last couple of years we released one of these *Air Buddies* movies and combined we sold over 5 million units on that. So that's on a very low budget movie, so they can be highly profitable. That's another area we are looking at.

Jessica Reif Cohen - *Analyst, Merrill Lynch*

Are you comfortable talking about the economics of that business? My [understanding] was it was like \$10 a unit in profit.

Alan Bergman - *President, Walt Disney Studios*

Actually, not really comfortable.

Jessica Reif Cohen - *Analyst, Merrill Lynch*

(Laughter) Okay.

Okay. In terms of just overall growth, do some of the current trends in the industry appear to be challenging - theatrical market, DVD, TV syndication, pay TV - we are not seeing a lot of growth in the areas where there is some growth, like digital and maybe video-on-demand, they are still so small that they're pretty insignificant. I was just curious if you could discuss what you think are the most exciting areas of growth over the next few years?

Alan Bergman - *President, Walt Disney Studios*

Well, I think the biggest area of growth is going to be in Blu-ray. Obviously, we were in a format war for, unfortunately, a prolonged period of time. But now it is behind us, retail is starting to get behind Blu-ray in a big way and you're going to see it this holiday season. So I think that's a big area of growth. In the mid-term, I think electronic sell-through is another area that will take off. It's more of a mid-term play.



We've sold over 5 million units on iTunes. So that's a nice area for us. And then we have something called DisneyFile, which is sort of the combination of the disc and an electronic version. I think you all have one on your desk, on your table there. You should check it out. It's really cool. You get the DVD or Blu-ray and an electronic version all on one package. So, it's really an interesting play right now.

Jessica Reif Cohen - *Analyst, Merrill Lynch*

Is there any area of the theatrical, all the windows that you see, at risk over the next few years?

Alan Bergman - *President, Walt Disney Studios*

I don't think so. I think that the economy is looking pretty tough right now and the theatrical business is down marginally. It is down, I think, a point, a point and a half. The DVD business is relatively flat. So, I don't really see any huge risk big picture.

Jessica Reif Cohen - *Analyst, Merrill Lynch*

You touched on music for a second in your presentation and it's been an area for the company that's grown dramatically over the last few years and obviously, I have a young, almost teenage daughter and we buy everything... legally. (LAUGHTER). I am just curious how do you think about developing the music business on the film side, and what is your role in music?

Alan Bergman - *President, Walt Disney Studios*

Well, the music was part of the Walt Disney Studios, so it's one of our four product lines and the guy who runs it, his name is Bob Cavallo - he's a fantastic guy. Some of you may have met him. He used to manage Prince and Alanis Morissette. He's done an unbelievable job working primarily with the Disney Channel, with Miley, some of the *High School Musical* product and then he brought in the *Jonas Brothers*. He's really incredible at working with young talent and bringing them up. And as you said, it's really grown over the last several years. It was basically a breakeven-ish business. Now it's doing quite well.



Jessica Reif Cohen - *Analyst, Merrill Lynch*

Can you define quite well within a range?

Alan Bergman - *President, Walt Disney Studios*

I probably can't. But we're really excited about that business and the returns have been really strong, so we're happy to have it part of the Studio.

Jessica Reif Cohen - *Analyst, Merrill Lynch*

[To] put it another way, you're probably the only growth music company in the world right now.

Alan Bergman - *President, Walt Disney Studios*

I think you're right. And I think that, as I said, I think it's what we talk about, the *Disney Difference*. It's just working with other parts of the company that give us a bit of an advantage and I think this is an area that clearly shows that.

Jessica Reif Cohen - *Analyst, Merrill Lynch*

Right. Just moving on to returns on invested capital, can you discuss what range your returns are and what your goals are?

Alan Bergman - *President, Walt Disney Studios*

Our returns have been strong double-digit returns and that's what our goal is going forward. That's really what we're looking for is strong double-digit return on invested capital.

Jessica Reif Cohen - *Analyst, Merrill Lynch*

Are you or your team compensated based on return on invested capital?



Alan Bergman - *President, Walt Disney Studios*

Absolutely. We have four key metrics that we look at. That's one of them. The other is, obviously, is operating income, cash flow and what we call economic profit. We are very, very focused on that.

Jessica Reif Cohen - *Analyst, Merrill Lynch*

Switching gears a little bit. On film financing, Disney was very early in using outside capital to fund films, the Silver Screen in 1980s was the first thing I can remember. You didn't come back to using third party financing or film financing vehicles until recently - last few years. Can you give us a sense of what percent of your films are in the Kingdom Films financing vehicle?

Alan Bergman - *President, Walt Disney Studios*

The Kingdom Films deal is essentially all of our live action films, excluding sequels. Miramax is also excluded as well, and no animation. In terms of live action, it's a majority of our films.

Jessica Reif Cohen - *Analyst, Merrill Lynch*

How much longer will this fund run?

Alan Bergman - *President, Walt Disney Studios*

It's a 32-picture deal and it should end, depending on timing, somewhere in the middle of next year, middle of '09.

Jessica Reif Cohen - *Analyst, Merrill Lynch*

Do you have an option to buy out your partner's interest in the films?

Alan Bergman - *President, Walt Disney Studios*

Yes, we do. At certain points in time we can buy them out based on a formula.



Jessica Reif Cohen – *Analyst, Merrill Lynch*

Will you seek to replace this, since it is coming up relatively soon, are you looking to replace it and can you replace it in this market?

Alan Bergman – *President, Walt Disney Studios*

I think we could replace it in this market. We're not actually sure if we're going to. It will really depend if we can get the right deal. As I said, we're focused on Disney-branded movies and because that's a strong area for us, we're not sure whether we actually want to do a deal.

Jessica Reif Cohen – *Analyst, Merrill Lynch*

So on the cost side, how will capital allocated to film production change in coming years?

Alan Bergman – *President, Walt Disney Studios*

I don't think it's going to change that much. It actually might pick up a little bit, not materially, but just a little bit. And it will also depend on just the timing of movies as they come in and out year to year. But over a long period of time, I don't think, over the next years, I don't think it's going to change materially.

Jessica Reif Cohen – *Analyst, Merrill Lynch*

Okay. And on the marketing promotion, advertising side of the business, given the softness in the ad market, is there an opportunity here to actually cut costs or, how do you see it over the next year or so?

Alan Bergman – *President, Walt Disney Studios*

As we've looked at it, we don't really see that much softness. It's relatively flat or maybe up a little bit. I think the costs are going to remain relatively flat. We spent a lot of time working on our marketing costs, trying to be as efficient as we can. But there's a lot of clutter out there and there is a certain amount of money that you do need to spend. I think it will be relatively flat.



Jessica Reif Cohen - *Analyst, Merrill Lynch*

And on the margin side of the business, your own chart shows a huge margin growth over the last few years. So where do you think you can take it? You're pretty much at the top end of the industry at this point.

Alan Bergman - *President, Walt Disney Studios*

We've certainly expanded our margin significantly over the last few years and movies like *Pirates* have been an important part of that and those are obviously difficult to comp. However, we're very focused on our margins and our return on invested capital and ultimately we'll see how our films perform over the next year or two and see how we do. We've got some great movies coming up and we'll just have to see.

Jessica Reif Cohen - *Analyst, Merrill Lynch*

And film financing, if you choose not to tap into that market, will that boost your margins.

Alan Bergman - *President, Walt Disney Studios*

No, it won't have any impact on our margins at all.

Jessica Reif Cohen - *Analyst, Merrill Lynch*

On digital, what do you see as the biggest opportunity?

Alan Bergman - *President, Walt Disney Studios*

Well, I think from a distribution standpoint, digital cinema in 3D is pretty interesting. By the end of this year, we'll probably have about 5,000 digital screens and I think by the end of next year, probably 15,000 digital screens. And 3D is, by the end of this year, 1,500 growing to 4,000, so I think that's a great opportunity from a theatrical standpoint. And then home entertainment, I think electronic sell-through, mid-term to long-term is going to be an interesting play. In terms of production, our CG animation is tailor made for 3D. It's in the computer, it's perfect for that. And then as I mentioned in my presentation, we've done this deal with Bob Zemeckis to develop a performance capture



studio, which is really amazing. It takes advantage of all the latest technologies and we can basically, in an open room, we can make any movie we want to make. Don't have to worry about weather. Don't have to worry about anything. And Bob is a tremendous film maker, so when you see *Christmas Carol*, I think you'll be impressed.

Jessica Reif Cohen – *Analyst, Merrill Lynch*

On piracy, can you discuss what you and the rest of the film industry is doing to avoid some of the pitfalls the music industry suffered with when they went to digital.

Alan Bergman – *President, Walt Disney Studios*

Clearly, it's a big problem. I think it's slightly different than the music business in the sense that they didn't want to buy the whole album, maybe they only wanted to buy a single. But it is a major problem. We are working with other studios and we're also working to get our product out there between iTunes and a variety of other mechanisms, we're trying to get our product out there so people have it available to buy.

Jessica Reif Cohen – *Analyst, Merrill Lynch*

Switch gears a little bit to Pixar and animation in general. Can you discuss how the integration with Pixar has gone compared with the original plan when you bought it in 2006?

Alan Bergman – *President, Walt Disney Studios*

It's going fantastic. I mean, we couldn't ask for more. We've spent a lot of money on that acquisition and we absolutely got our money's worth. What John and Ed, in particular, have been able to do across the company, not just at the studio, but the theme parks, consumer products, is tremendous. We're very happy with it.

Jessica Reif Cohen – *Analyst, Merrill Lynch*

Do you think it had a big impact on the Disney animated film, *Bolt*, that you showed us a clip of?



Alan Bergman - *President, Walt Disney Studios*

Absolutely. I hope you guys enjoyed that. They definitely have been very involved in that movie - as they are involved in many of our movies and our direct-to-videos - so I think it's going to be fantastic.

Jessica Reif Cohen - *Analyst, Merrill Lynch*

And then the last question, on the theatrical production or live shows, can you give us a sense if that area - you've had such an amazing run with *Lion King*, *Beauty and the Beast*, *Mary Poppins*. Wondering if the tremendous success you've had, if you feel like you've peaked, or is there another leg up to growth given some of the productions you have now?

Alan Bergman - *President, Walt Disney Studios*

Well, it has been relatively flat over the last several years and we'll have to find that property that takes it to the next level. But the fact is that we have strong returns in this business and we're very comfortable with where we're at. It's a great business for us.

Jessica Reif Cohen - *Analyst, Merrill Lynch*

What other potential titles would you have?

Alan Bergman - *President, Walt Disney Studios*

We're looking at a lot of titles. It's really too early to say at this point. But there are a couple things that we're looking at that are very interesting, I think people would enjoy.

Jessica Reif Cohen - *Analyst, Merrill Lynch*

All right. Well, thank you very much.

Alan Bergman - *President, Walt Disney Studios*

Sure.

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- the advertising market for broadcast and cable television programming;
- expenses of providing medical and pension benefits;
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